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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, January 19, 1999

APPLICATION OF

CASE NO. PUA980035

ROANOKE GAS COMPANY  
AND  
COMMONWEALTH PUBLIC SERVICE  
CORPORATION

For approval of transactions under  
Chapters 4 and 5 of Title 56 of the  
Code of Virginia

**ORDER GRANTING APPROVAL**

On October 21, 1999, Roanoke Gas Company (“Roanoke” and Commonwealth Public Service Corporation (“Commonwealth”), collectively referred to as “the Applicants,” filed an application with the Commission under the Public Utilities Affiliates Act and the Utility Transfers Act. In the application, the Applicants request approval to enter into certain transactions with their affiliates in order to effect their merger, the reorganization of their corporate structure, and the creation of a holding company.

Roanoke Gas Company is a Virginia public service company that provides retail distribution and sale of natural gas to approximately 48,600 customers in Roanoke, Virginia, and surrounding areas in Virginia. Bluefield Gas Company (“Bluefield”) is a West Virginia public service company and is a wholly owned subsidiary of Roanoke. Bluefield provides natural gas service to approximately 4,100 customers in and around Bluefield, West Virginia. Bluefield owns

all of the issued and outstanding stock of Commonwealth Public Service Corporation, a Virginia public service company that provides natural gas service to approximately 925 customers in Bluefield, Virginia, and surrounding areas in Virginia.

As described in the application, Roanoke owns 100% of the outstanding common stock of Diversified Energy Company (“Diversified”), a Virginia corporation that is not a public utility. Diversified is headquartered in Roanoke, Virginia, and sells propane and propane related products. Diversified serves approximately 10,500 active propane accounts in southwestern Virginia and southern West Virginia.

Roanoke currently provides managerial and other services, labor, and goods to Bluefield and Diversified under agreements approved by the Commission in Case No. PUA860077 and approved by the West Virginia Commission.

RGC Resources, Inc. (“Resources”), a Virginia corporation, was incorporated on July 31, 1998, for the purpose of accomplishing the proposed merger and reorganization. Resources owns all of the outstanding common stock of RGC Acquisition Corp. (“Acquisition”), a Virginia corporation formed on August 12, 1998, also for the purpose of accomplishing the proposed merger and reorganization. Neither Resources nor Acquisition owns any utility assets or engages in any business.

In the application filed by Roanoke and Commonwealth, authority is requested for certain transactions under Chapters 4 and 5 of the Code of Virginia in order to effect a merger with its affiliates and to reorganize the corporate structure and create a holding company. Authority also is requested to enter into certain affiliate agreements for the provision of certain services.

## Merger and Restructuring

As stated in the application, Roanoke and Commonwealth, together with Bluefield, Diversified, Resources, and Acquisition, intend to accomplish the proposed merger and reorganization by entering into an Agreement and Plan of Merger and Reorganization whereby (1) Roanoke will be merged into Acquisition, with Roanoke as the surviving corporation; (2) the common stock of Acquisition owned by Resources will be converted into the new common stock of Roanoke; (3) the outstanding shares of Roanoke common stock will be converted into the right to receive, on a one-for-one basis, shares of Resources common stock on the merger effective date; (4) Bluefield, by means of a non-cash dividend, will transfer to Roanoke all of the outstanding common stock of Commonwealth; (5) Roanoke, by means of a non-cash dividend, will transfer to Resources all of the outstanding common stock of Bluefield and Diversified; and (6) Commonwealth will be merged into Roanoke Gas Company. Following the proposed merger and reorganization, Roanoke, Bluefield, and Diversified will each be wholly owned subsidiaries of Resources, and all of the outstanding common stock of Resources will be owned by the former Roanoke Gas Company shareholders.

According to information contained in the application, Roanoke and Resources have applied to the Securities and Exchange Commission (the “SEC”) for necessary approvals under Section 10 of the Public Utility Holding Company Act of 1935 (“PUHCA”). Pursuant to 17 C.F.R. § 250.2 under PUHCA, Resources intends, upon consummation of the merger and reorganization, to file a claim of exemption as a holding company under Section 3(a)(1) of PUHCA, on the basis that Resources and every public utility subsidiary thereof from which Resources derives, directly or indirectly, any material part of its income are predominantly intrastate in character and carry on their business in Virginia, the state in which Resources and

every such material subsidiary are organized. The attached exhibit shows the proposed merger and reorganization with the present structure, proposed reorganization, and final configuration.

Affiliate Agreement between RGC Resources, Inc., and Roanoke Gas Company

The Affiliate Agreement between RGC Resources, Inc., and Roanoke Gas Company (“the Resources-Roanoke Agreement”) will cover executive, administrative, accounting, public relations, information systems, data processing services, and other services provided by Roanoke to Resources. Expenses of Resources incurred by it on behalf of Roanoke will be assigned to Roanoke and recorded in accounting records of Roanoke. Expenses of Roanoke incurred by it on behalf of Resources will be assigned to Resources and recorded in Resources’ accounting records. Roanoke will pay dividends to Resources based on the dividend policy and capital structure targets set by the Board of Directors of Roanoke. Either party may terminate the agreement with a sixty-day notice to the other party.

Affiliate Agreement between Roanoke Gas Company and Bluefield Gas Company

The Affiliate Agreement between Roanoke Gas Company and Bluefield Gas Company (“the Roanoke-Bluefield Agreement”) will cover executive, administrative, accounting, public relations, information systems, data processing services, and other operational services provided by Roanoke to Bluefield and administrative and operational services provided by Bluefield to Roanoke. Expenses incurred by Roanoke on behalf of Bluefield that are identifiable as directly assignable to Bluefield will be directly assigned to Bluefield in the accounting records of Roanoke and Bluefield. Expenses incurred by Bluefield on behalf of Roanoke that are identifiable as directly assignable to Roanoke will be directly assigned to Roanoke. Expenses incurred by Roanoke on behalf of Bluefield that are not identifiable as directly assigned will be allocated to Bluefield according to the schedule of cost allocations filed with the application. Expenses

incurred by Bluefield on behalf of Roanoke that are not identifiable as directly assigned will be allocated to Roanoke according to the same schedule of cost allocations previously mentioned.

Either party may terminate the agreement with a sixty-day notice to the other party.

Affiliate Agreement between Roanoke Gas Company and Diversified Energy Company

The Affiliate Agreement between Roanoke Gas Company and Diversified Energy Company (“the Roanoke-Diversified Agreement”) will cover executive, administrative, accounting, public relations, information systems, data processing services, and other operational services provided by Roanoke to Diversified; and administrative and operational services provided by Diversified to Roanoke. Expenses incurred by Roanoke on behalf of Diversified that are identifiable as directly assignable to Diversified will be directly assigned to Diversified in the accounting records of Roanoke and Diversified. Expenses incurred by Diversified on behalf of Roanoke that are identifiable as directly assignable to Roanoke will be directly assigned to Roanoke in the accounting records of Roanoke and Diversified. Expenses incurred by Roanoke on behalf of Diversified that are not identifiable as directly assigned will be allocated to Diversified in accordance with the schedule of allocations filed with the application. Expenses incurred by Diversified on behalf of Roanoke that are not identifiable as directly assigned will be allocated to Roanoke in accordance with the same allocations schedule previously mentioned. Either party may terminate the agreement with a sixty-day notice.

In support of the restructuring, the Applicants state that the proposed restructuring will be in the public interest because it will create a structure that can more effectively address the increased competition in the energy industry, refocus various utility activities, facilitate selective diversification into non-utility businesses, afford further separation between the utility and non-utility businesses, and provide for flexibility for financing. The two primary reasons given in the

application for restructuring are to better position Roanoke to deal effectively with the competitive environment developing within the energy industry and to best deploy shareholders' capital both inside and outside of the utility industry. The application further states that the objectives can most effectively be accomplished through the restructuring. The restructuring provides the necessary flexibility required to meet competitive challenges and to diversify while further insulating the utility business from the risks of the non-utility businesses by segregating the non-utility businesses into separate corporations that will be direct subsidiaries of the holding company and not of Roanoke.

It is further stated in the application that because non-utility businesses of the holding company will be conducted through separate subsidiaries, any liabilities incurred by those subsidiaries will not constitute liabilities of the utility subsidiaries. As stated in the application, the corporate separation also insures that all costs of a particular non-utility subsidiary will be charged to that subsidiary and not allocated to any utility subsidiary.

As indicated in the Transaction Summary filed with the application, Roanoke and Commonwealth represent that adequate service to the public at just and reasonable rates will not be impaired or jeopardized by the proposed merger and reorganization. Customers of Roanoke and Commonwealth will see no change as a result of the proposed transfer of control. The rates of Commonwealth will be combined with the rates of Roanoke during the next Roanoke Gas Company rate case. Commonwealth and Roanoke further represent that the direct benefits to customers of the proposed merger and restructuring will be the result of economies of scale through the elimination of separate rate filings, separate Actual Cost Adjustment ("ACA") and Purchased Gas Adjustment ("PGA") filings, separate Annual Information Filings, and improved gas purchasing power for the combined companies. As further stated in the Transaction

Summary, there will be no immediate impact on rates and service, capital structure (except for the simple merger of Roanoke and Commonwealth) or access to capital and financial markets. It is further stated that in future rate cases, the restructuring will afford continuing use of economies of scale and increased financial flexibility that should result in lower rates and better service.

Likewise, there should be no immediate impacts on employee levels, facilities and other interests of the Commonwealth of Virginia. However, as indicated by the Applicants, in the long-term, the public interest will be served by permitting a strengthened public utility to serve customers and by separating non-utility businesses and permitting them increased flexibility.

Concerning the public interest aspect of the affiliate agreements, it is stated in the application that all of the affiliate agreements discussed above allow for economies of scale in the operation through shared management and centralized facilities; therefore, they are in the public interest both in the aggregate and individually. Given the nature of the services provided within the scope of the proposed affiliate agreements, each affiliate will be providing and purchasing services from its affiliate at cost. No profit other than return on assets used will be included in cost. No services will be provided that are not already being provided under previously existing affiliate agreements. In the Transaction Summary filed with the application, it is represented that the regulated company as a result of the proposed affiliate agreements will subsidize no unregulated affiliate.

THE COMMISSION, upon consideration of the application and representation of the Applicants and having been advised by its Staff, is of the opinion and finds that the proposed merger and reorganization of the corporate structure of Roanoke and its affiliates and the creation of the holding company, RGC Resources, Inc., would neither impair nor jeopardize the provision

of adequate service to the public at just and reasonable rates by Roanoke and Commonwealth and therefore should be approved.

The Commission is of the further opinion and finds that the affiliate agreements proposed by the Applicants are in the public interest and should be approved. However, the agreements contain a category of “other” services. The Commission finds that its approval should be only for specific categories of services described in each of the agreements and should not include categories described as “other.” In addition, the Commission notes that, in the Resources-Roanoke Agreement, there is no provision as to how charges to Resources will be allocated to the benefiting subsidiaries, such as Roanoke. Therefore, within sixty days after the date of this order, Roanoke should file an application for approval of a proposed procedure for allocating such charges.

Furthermore, even though the majority of services provided under the agreements would be appropriately priced at cost, certain services included in the Roanoke-Diversified Agreement should be priced at the higher of cost or market. Some services contained in the Roanoke-Diversified Agreement could conceivably be obtained from outside third parties and, therefore, a market and a market price would exist. Such services include customer billing services, credit and collection services, and applications programming support services. For these services and any others for which there might be market from which Diversified could purchase such services, Roanoke should ascertain whether there is a market from which Diversified could purchase such services. If so, Roanoke should compare such market prices to its cost of providing services and charge Diversified the higher of the cost of obtaining services from an outside party (the market) or Roanoke’s cost. This also would be the case in the Resources-Roanoke Agreement for services benefiting Diversified exclusively and for which a market exists. Roanoke should bear



the burden, in any rate proceeding, to show that for any services provided to or for the benefit of Diversified, for which there is a market price for such services, Roanoke recovered the higher of cost or market. Accordingly,

IT IS ORDERED THAT:

- 1) Pursuant to §§56-89 and 56-90 of the Code of Virginia, Roanoke Gas Company and Commonwealth Public Service Corporation are granted approval of the proposed merger and reorganization of their corporate structure, to include a holding company structure which would result in Commonwealth merging into Roanoke and ceasing to exist and RGC Resources, Inc., as the resulting holding company as described herein.
- 2) Pursuant to §56-77 of the Code of Virginia, Roanoke Gas Company is granted approval to enter into the affiliate agreements under the terms and conditions and for the purposes as described herein, subject to certain modifications.
- 3) The approval granted herein shall include specific categories of services described herein and shall not include any categories labeled as “other.”
- 4) Relative to the Roanoke-Diversified Agreement, certain services such as customer billing services, credit and collection services, and applications programming support services and any other services for which a market might exist, Roanoke shall ascertain whether there is a market from which Diversified could purchase such services. If so, Roanoke shall compare such market prices to its cost of providing services and charge Diversified the higher of the cost for obtaining services from an outside party (the market) or Roanoke’s cost.
- 5) Relative to the Resources-Roanoke Agreement, for any services benefiting Diversified, and for which there is a market, such pricing shall be at the higher of cost or market.

- 6) Roanoke Gas Company shall bear the burden, in any future rate proceeding, to show that for any services provided to or for the benefit of Diversified, for which there was a market at the time the service was provided and therefore a market price for such services, Roanoke recovered the higher of cost or market.
- 7) Should there be any changes in the terms and conditions of the affiliate agreements from those contained herein, Commission approval shall be required for such changes.
- 8) The approvals granted herein pursuant to §56-77 of the Code of Virginia shall not preclude the Commission from exercising the provisions of §§56-78 and 56-80 of the Code of Virginia hereafter.
- 9) The approvals granted herein shall have no ratemaking implications.
- 10) The Annual Information Filing requirements will remain the same for Roanoke and Commonwealth until Roanoke files a rate case reflecting the merger as approved by the Commission.
- 11) The Commission reserves the right, pursuant to §56-79 of the Code of Virginia, to examine the books and records of any affiliate of Roanoke Gas Company in connection with the approvals granted herein pursuant to §56-77 of the Code of Virginia whether or not such affiliate is regulated by the Commission.
- 12) Within sixty days from the date of this Order, Roanoke shall file an application with the Commission for approval of an amendment to the Resources-Roanoke Agreement to include a provision for allocating charges back to subsidiaries.
- 13) The Applicants shall file a report of the action taken pursuant to the approval granted herein under the Utility Transfers Act with the Commission by no later than April 30, 1999, subject to extension by the Director of Public Utility Accounting of the

Commission. Such report shall include the date the merger and reorganization were consummated, the total number of shares of stock converted and the price per share following the merger, and a final organization chart showing the actual post-reorganization structure.

- 14) Roanoke shall file a report with the Director of Public Utility Accounting of the Commission on or before May 1 of each year, the first of which shall be due on or before May 1, 1999, subject to extension by the Director of Public Utility Accounting of the Commission. Such report shall show services provided to and by Roanoke and charges for such services for the preceding calendar year. The report shall include all transactions with affiliates, and this requirement shall supersede all affiliate reporting requirements previously ordered.
- 15) This matter shall be continued generally subject to the continuing review, audit, and appropriate directive of the Commission.